

FISCAL NOTE

Bill #: HB0381

Title: Repeal contractor registration

Primary

Sponsor: Brad Molnar

Status: As introduced

Sponsor signature	Date	Dave Lewis, Budget Director	Date
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Fiscal Summary

	<u>FY2000 Difference</u>	<u>FY2001 Difference</u>
Expenditures:		
State Special Revenue (Contractor Registration and) Independent Contractor)	\$ 90,798	\$ 85,209
Other (Proprietary Fund)	\$383,648	\$383,648
Revenue:		
State Special Revenue	(\$388,279)	(\$58,279)
Other (Proprietary Fund)	0	0
Net Impact on General Fund Balance:	0	0

<u>Yes</u>	<u>No</u>		<u>Yes</u>	<u>No</u>	
X		Significant Local Gov. Impact	X		Technical Concerns
	X	Included in the Executive Budget	X		Significant Long-Term Impacts

Fiscal Analysis

ASSUMPTIONS:

Department of Labor and Industry,

Contractor Registration and Independent Contractor Unit

1. Repeal of Construction Contractor Registration will completely eliminate contractor registration funding and responsibilities for the Legal Bureau and Hearings Bureau within the Legal Services Bureau.
2. Since an independent contractor exemption is no longer required, there will be a reduction in the number of exemptions requested. There will be an estimated 30% reduction in the number of independent contractor exemptions issued.

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3. The decrease in the number of individuals obtaining exemptions will cause a potential increase in the number of cases before the Legal Bureau and the Workers' Compensation Court as the parties attempt to determine whether the worker actually "represents to the public" that they are an independent contractor.
4. Section 39-71-120(2) and 39-71-401(3)(c) will increase legal cases to the Workers' Compensation Court as the worker and employer litigate the fact issue of whether a person "represents to the public" that the worker is an independent contractor. As the department cannot establish rules, the Workers' Compensation Court will need to determine what is envisioned by "represents to the public."

Uninsured Employers Fund

5. The Uninsured Employers Fund relies on 39-71-405, MCA, to hold prime contractors responsible for insuring employees and individuals with whom they contract for work or for checking to see if those individuals have coverage or exemptions.
6. The Uninsured Employers Fund attempts to bring uninsured employers into compliance with the workers' compensation laws. This includes mandatory workers' compensation insurance in most cases.
7. The Uninsured Employers Fund is funded by collecting penalties from employers who are uninsured when determinations are made that workers are employees rather than independent contractors who have obtained exemptions from the Department of Labor.
8. The Uninsured Employers Fund provides benefits to employees injured on the job while working for an uninsured employer.
9. Workers will be injured on jobs where they represent themselves as independent contractors pursuant to 39-71-120, MCA.
10. Litigation would increase to make determinations if a worker was an independent contractor and, therefore, legal costs would increase. Amount of increase cannot be determined at this time.
11. During FY 1998, there was \$834,430 paid out in medical and wage loss benefits for 121 claims.
12. Benefits paid to injured workers are based on the number of penalties assessed and collected by the Uninsured Employers Fund.
13. If the changes were made to the independent contractor definition under 39-71-120 and 39-71-405, MCA, claims costs would increase by 25%, approximately 35 claims due to the IC issue which would be denied. If one-third to one-half of those denials are litigated, then the legal unit would receive 12 to 16 additional claims for litigation. The average benefit denial case takes approximately 120 hours to complete (120 hours x 12 = 1,440 – 120 x 16 = 1,920, which equates to 1.00 FTE).
14. Many employers would choose to use workers as independent contractors so as not to purchase workers' compensation insurance. This would have a devastating effect on the fund, since there would be no way to determine credibility of the claims made and costs would increase as claims were filed by workers/independent contractors. An increase could be seen in the first year.
15. Decisions are made to determine clarification of the definition of independent contractors by the Independent Contractor Central Unit, the Hearings Unit, and the Workers' Compensation Court.

Unemployment Insurance Division

16. It is possible that wages reported by employing entities would decrease as individuals who are currently determined to be employees may become independent contractors. A reduction in wages reported by employers may reduce the amount of taxes paid by employers, which in turn could have a negative impact to the UI trust fund.
17. There is no data available to determine the fiscal impact because the number of decreasing employing entities cannot be determined.
18. Individuals who are independent contractors would still be able to file a claim for UI benefits and receive a determination of eligibility as outlined in 39-51-2402, MCA.

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19. Section 39-71-120(2) will reduce the number of individuals working as employees because any worker can be called an independent contractor and the department cannot investigate the working relationship. This will reduce revenues to withholding and unemployment insurance and will also reduce the workers' compensation premiums paid. A study of current independent contractor exemption holders found 17% of the contractors did not file business taxes and 25% did not file taxes at all. The study found the impact of lost revenue to be \$1,673,595 to Unemployment Insurance, \$1,817,172 to \$3,634,344 lost revenue to income withholding and \$3,690,225 in lost workers' compensation premiums. These numbers will be expanded by the proposed change.

State Fund:

20. Premium revenue may be lost from construction contractors electing not to maintain coverage on themselves. The State Fund would also lose the liability of benefits payments on these claims.
21. Premium revenue may be lost on policies elected by independent contractors who were previously classified as employees. The policies elected by independent contractors will allow them to establish levels of workers' compensation insurance coverage and not be payroll based as when they were classified as employees.
22. An increase in the volume of policies and administrative cost associated with servicing the policies of independent contractors who elect workers' compensation coverage and who were previously classified as employees included on an employer's policy is anticipated.
23. Section 3 of the bill impacting 39-71-401(3)(c), MCA, and Section 4 impacting section 39-71-405, MCA, would not be limited to "construction contractors".
24. Section 2, impacting 39-71-120, MCA, would eliminate the presumption of employee status in a working relationship.
25. Construction contractors and independent contractors would continue to be allowed to elect to provide workers' compensation coverage on themselves.
26. Construction contractors and independent contractors would continue to be allowed to elect the level of coverage on themselves for workers' compensation purposes.
27. The State Fund will need to audit the premium paid on all policyholders with construction industry class codes to ensure premiums paid are as required based on reported payrolls.
28. In FY 1998, there were 1,039 construction industry audits completed at an average cost of \$152 per audit.
29. The State Fund will be required to perform audits on all policies in the construction industry. In FY98 there were 3,563 State Fund policyholders with a construction industry governing class code.
30. Based on the volume of FY 1998 construction industry policyholders, the State Fund would be required to perform an additional 2,524 payroll audits. Using the FY 1998 average cost per audit this equates to an increase in expenditures of \$383,648.
31. Revenue to offset the increased expenditures due to additional audit requirements will be reflected in subsequent year premium rate adjustments.
32. There will be increased litigation involving the State Fund as a result of the imprecise language in the bill further described in technical note #8. The cost of the increased litigation cannot be determined.
33. There will be additional administrative cost for collecting additional premium from contractors who, because of litigation, are found to be liable for injuries. The State Fund will be responsible for collecting the additional premium to cover the risk.
34. HB381 allows contracting parties to agree to an independent contractor status without the application process, \$25 fee, and approval of the Department of Labor and Industry. This causes no fiscal impact to the State Fund.

Office of Public Instruction:

34. There is no direct fiscal impact on OPI or state payments to schools. The impact on school district liability insurance or legal costs is impossible to project for this legislation.

35. The Departments of Commerce and Public Health and Human Services have reviewed the proposed legislation and could not determine any fiscal impact to their departments as a result of HB381.

FISCAL IMPACT:

Department of Labor and Industry:

	<u>FY2000 Difference</u>	<u>FY2001 Difference</u>
FTE	(2.00)	(2.00)
<u>Expenditures:</u>		
Personal Services	(\$ 55,261)	(\$ 55,000)
Operating Expenses	(\$ 71,152)	(\$ 71,457)
Equipment	\$ 5,545	0
Benefits (Medical and Wage Loss)	<u>\$211,666</u>	<u>\$211,666</u>
TOTAL	\$ 90,798	\$ 85,209
<u>Funding:</u>		
State Special Revenue (02)	\$ 90,798	\$ 85,209
<u>Revenues:</u>		
State Special Revenue (02)	(\$388,279)	(\$ 58,279)
<u>Net Impact to Fund Balance (Revenue minus Expenditure):</u>		
State Special Revenue (02)	(\$474,077)	(\$138,488)

State Fund:

	<u>FY2000 Difference</u>	<u>FY2001 Difference</u>
<u>Expenditures:</u>		
Operating Expenses	\$383,648	\$383,468
<u>Funding:</u>		
Proprietary Fund (06)	\$383,648	\$383,648
<u>Revenues:</u>		
Proprietary Fund (06)	0	0
<u>Net Impact to Fund Balance (Revenue minus Expenditure):</u>		
Proprietary Fund (06)	\$0	\$0

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EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:

Theoretically an uninsured employer would no longer exist until a court made a determination. Therefore, litigation and lawsuits would increase for employers at every level.

LONG-RANGE IMPACTS:

The Uninsured Employers Fund is self-funded and could become insolvent when penalties could not be assessed or collected and funds would have to be paid out for benefits for current claims, new claims and administration of the fund.

TECHNICAL NOTES:

1. Section 39-71-405 is so changed that it works as a repealer for the entire contractor registration law, with the exception of the definitions section.
2. The proposed amendment conflicts with the current definition contained in 39-71-116(7), MCA, because under -405(3), casual employment exists even when the work performed is in the usual course of the trade, business, profession or occupation of the employer.
3. Section 39-9-102, MCA, is the only remaining section in the construction contractor registration laws. Section 39-9-102, MCA, is a definition section with only two subsections: (1) defining “construction contractor” and (2) defining “department.” The only use of the defined term “construction contractor” is in proposed 39-71-401(2)(t), MCA. The definition might be more appropriately added to 39-71-116, MCA, and then 39-2-102, MCA, could be repealed.
4. The changes made for contractors in workers’ compensation do not appear to apply to other areas of law, such as Unemployment Insurance and Wage and Hour. HB381 may create confusion.
5. If the standards for determining independent contractor status are different for workers’ compensation than for other areas of law, it does not make sense to transfer all IC determinations to the Workers’ Compensation Court, as is being proposed by HJR10.
6. Social costs are associated with the shift from covered employment to non-covered work performed by independent contractors. Besides potential loss of state income tax revenue from non-reporting of income or non-withholding of taxes, the costs for medical treatment of uninsured independent contractors would be spread across various sectors of the economy (social services and unpaid medical providers). In addition, lost income resulting from an injury would not be directly replaced, and the injured worker and any dependents could become dependent on social services.
7. This bill impacts statute related to all contractors and independent contractors and is not limited to construction contractors as the title implies.
8. Section 39-71-401,(3)(c), MCA, does not require written documentation between contracting parties when agreeing to independent contractor status. This has the potential for parties to misinterpret who is liable for work related injuries of employees. Parties agreeing to independent contractor status may under-insure their risk or to have employees that are not covered for work related injuries.
9. The apparent verbal representation of independent contractor status may not ultimately be upheld if a worker was not, in fact, an independent contractor. This may cause benefit payments to be made without collection of commensurate premiums.